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SUBJECT: FOREIGN BANKERS PESSIMISTIC ABOUT THE FUTURE IN
ARGENTINA; ARGENTINE CONTACTS PREDICT DIFFICULT 2009 IF GOA
FAILS TO CHANGE TACTICS

REF: BUENOS AIRES 991

Classified By: Ambassador E.A. Wayne for Reasons 1.4 (b,d)

Summary

1. (C) Foreign financial sector representatives gave visiting Treasury DAS Brian O'Neill a pessimistic assessment of the state of the Argentine economy and prospects for improvements in GoA economic policies during a July 11 meeting. They agreed on the likelihood of a sharp economic deceleration going forward, noting that Argentina is affected by turmoil in the global economy, the country is worn out by the farm crisis, and the GoA has made major strategic errors during 2008. Although they concluded that the country would avoid a crisis as long as it maintains trade and fiscal surpluses, they agreed that the interventionist Kirchner economic policy model of using stimulative macro policies to boost domestic consumption and offsetting micro controls and subsidies policies to staunch inflationary pressure on prices is spent. Furthermore, given high inflation and rising poverty, the bankers thought President Cristina Fernandez de Kirchner would not be able to recover her previous popularity levels. Both foreign and domestic financial sector players are increasingly nervous, because they know that banks are always among the first to be scapegoated by the GoA when the economy sours. In a separate conversation July 29, the Presidents of the Stock Market and Argentine Securities Commission and a successful Argentine businessman told Ambassador that though the second half of 2008 would probably be fine, 2009 would be a very difficult year, as Argentina will have limited access to markets to meet its financial needs. A basic requirement to pull out of the current problems is to restore credibility of statistical figures, and that will be hard to do, they argued. End Summary.

2. (C) Treasury Deputy Assistant Secretary Brian O'Neill met July 11 with representatives of the major foreign financial institutions operating in Argentina. Top Executives from Citi, Prudential, American Express, HSBC, Santander, and Deutsche Bank participated. Separately on July 29, the Ambassador had a two hour discussion with the President of the Buenos Aires Stock Exchange, the President of Argentina's SEC equivalent, and the CEO of Pampa Energy on similar topics.

Citibank: Banks cautious due to high uncertainty and unpredictability

3. (C) Citibank-Argentina President Juan Jose Bruchou started off with a gloomy assessment of the impact of the uncertainty of the last few months and the likelihood of a strong

economic deceleration going forward. After many great years for the economy and financial sector, the months March through July have been difficult, with spiking inflation in February and March and the farm crisis beginning mid-March causing a mini-run on the peso. Peso deposits plunged 6-8% during March-June, with May the worst month. Banking sector liquidity fell sharply as people sought to buy dollars, convert peso deposits to dollars, convert long-term deposits to short-term, and get hard currency out of Argentina altogether. The Argentine Central Bank's quick action to begin selling dollars in the spot and futures markets stabilized markets and stopped the run on the peso, but at a steep cost.

14. (C) The BCRA's actions exacerbated the liquidity crunch (by taking pesos out of the market), and despite attempts to inject liquidity through bond purchases, the result was much higher inter-bank and consumer credit interest rates and the peso appreciating to its current level of almost 3 pesos/dollar. Bruchou noted that despite some recovery in consumer credit, credit to the private sector has stagnated. Inflation is still well above 20%, and while it has stabilized with the deceleration of the economy, he expects it to stay at this level due to indications that the GoA intends to increase spending to boost growth and rebuild CFK's political popularity. Due to high inflation, the farm strike, and the appreciated peso, Bruchou predicted that real growth would drop to 2-3% in 2009. He lamented that the high level of uncertainty and unpredictability of GoA policies had created an extremely negative climate for doing business. Despite the financial sector's strong performance until now, he said, "our inability to read the medium to long term, and

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the government's unwillingness to correct (its errant policies) has left banks moving cautiously."

Prudential: "We think change is logical; the Kirchners think differently"

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15. (C) Prudential Financial President Martin Gauto chimed in to point out that, when President Cristina Fernandez de Kirchner (CFK) took office in December 2007, the main economic concerns were high inflation, inadequate energy supply (and resulting shortages), and questions about the sustainability of the fiscal surplus. Now, he argued, these specific concerns are superseded by the broader themes of great uncertainty and unfriendly business environment, which permeate throughout the economy and have brought private sector investment to a full stop. A large part of the uncertainty, in his opinion, is the realization that former President Nestor Kirchner is still in full control of the government, and when faced with problems (e.g. the farm crisis, a slowing economy), he "always doubles the bet."

16. (C) Gauto emphasized the fundamental disconnect between the thought process and priorities of the private sector (and most other observers) and the current administration. "We all think that change is logical; the Kirchners think differently." If asked the question about what needs to be fixed or resolved, Gauto added, "the Kirchners think: 'there's nothing that needs resolving.'" When DAS O'Neill pointed to the need to rebuild credibility at Argentine statistical agency INDEC, Gauto said this was a perfect example of what he was explaining: "Nestor Kirchner thinks, 'what is there to fix?'"

AMEX: We "can only speak to Redrado, and he has no power"

17. (C) American Express President Jose Maria Zas commented that due to high inflation and recent high interest rates, AMEX has seen a rapid increase in credit card delinquency rates. He echoed others' comments that the previous four years have been a tremendous growth phase, but it is impossible to predict what will happen over the next six months. He noted increasing signs of rapid economic

deceleration, highlighting as an example that tourism, which has enjoyed double its historical growth rate since the 2002 crisis, is now faltering (due to increasing costs, the appreciating peso, and the GoA's interference in the operations of primary domestic airline Aerolineas Argentinas). He accused the GoA of being totally isolated from the business sector, so does not understand the extent of the problems. Zas commented that the ONLY Argentine official the private sector can speak to about these concerns is BCRA President Redrado, "who has no power." All others present agreed with this comment, with Citi's Bruchou stating that, with Nestor Kirchner running everything, there is no one else in the GoA worth talking to. The Deutsche Bank rep was even more candid, stating that the GoA simply does not think it needs to hear from the private sector.

HSBC: Political crisis is affecting expectations

18. (C) HSBC President Antonio Losada argued that the political crisis related to the farm strikes has strongly affected economic expectations for both the general public and private sector. Consequently, both have become more cautious, contributing to the economic slowdown. As long as the twin surpluses persist, he said, the country will stay in decent shape, but this depends heavily on exports from the agricultural sector. (At the time of the meeting, the farm strike was ongoing and ag exports had slowed significantly; that changed July 18 when the GoA repealed the March 11 decree to increase export taxes. See Ref A.) Losada added to previous comments that, in addition to the lack of high-level interlocutors, the GoA lacks technical expertise in the key economic ministries, so there are few capable of even recommending good policies.

19. (C) Losada also commented that debt issues were going to become more problematic going forward, with the GoA's financing needs doubling from the 2008 level to \$10-11 billion per year in 2009 through 2011. With very limited access to international finance (due to holdout bondholder lawsuits), high interest rates, a global liquidity crunch, and decelerating Argentine and world economies, Losada noted

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that the GoA would find it harder than in recent years to come up with needed gap financing. Nevertheless, he thought the GoA would succeed in finding local funding sources, and commented that increasing fears in the market about another GoA debt default are mostly due to the perception that the GoA lacks the willingness to pay, but not the ability to pay.

Santander: Hard to reverse CFK's fall in popularity

110. (C) Santander Rio Chief Economist Gabriel Ribisich noted how unbelievable it was that CFK's popularity had plunged so quickly, with her "negative image" topping 50% after just six months in office. He predicted this would be hard to reverse even with a resolution of the farm crisis, given that inflation is still in the 25-28% range and poverty, which had dropped towards 20%, was now back in the range of 30%.

Deutsche Bank: "Kirchner Model" is done

111. (C) Deutsche Bank Managing Director Gustavo Canonero built on Ribisich's comments, laying out the difficult situation facing Cristina. First, Argentina is affected by turmoil in the global economy (financial crisis, decelerating growth, increasing inflation, high commodity prices). Second, the country is worn out by the ongoing political crisis, the Kirchner economic policy model is spent, and the GoA has made major strategic errors during 2008. He commented that the Kirchners have yet to realize that the playing field has shifted. Their model of using stimulative macro policies to boost domestic consumption and offsetting micro controls and extensive subsidies to try to staunch price increases has only worked as long as it has, he alleged, due to the "miracle of high soy prices." Citi's

Bruchou agreed with this general theme, arguing that the "Kirchner Model" worked as long as there was a large output gap, as existed after the 2001/02 crisis, but now the country needed investment.

¶12. (C) Canonero said the Kirchners' actions over the next few months would determine the fate of the Argentine economy.

He commented that the dilemma that the BCRA faces is that, while inflation is falling due to the appreciated peso, higher rates, and the decelerating economy, this also leads to lower revenues, the loss of industrial competitiveness, and pressure on the trade surplus as the demand for imports grows. So the question is, how the GoA will react? He thought that all signs point to the GoA's continuation of its pro-cyclic efforts to pump up consumer-led growth by increasing subsidies, salaries, and pensions. He argued that Nestor Kirchner believes he needs at least six percent growth to sustain the model, and is therefore opposed to any attempt to cool the economy.

¶13. (C) Therefore, Canonero argued, the BCRA's current policies will soon be at odds with Nestor Kirchner's goal of re-igniting growth. Canonero thought the tipping point going forward will be whether the Kirchners try to recuperate what they had before the farm strike. "Kirchner does not understand the new reality," Canonero insisted, "and it will probably take three/four months more for it to sink in...for now he still thinks Argentina can return to its high growth rate after the farm strikes end." On the contrary, Canonero said he expected a sharp deterioration in growth "within the next six to twelve months." Nevertheless, he argued that this "will force the GoA to change policies, so that is the positive side."

Local Perspective: Have to fix INDEC and change tactics

¶14. (C) In a two-hour conversation on July 29 with the Ambassador, the President of the Buenos Aires Stock Exchange Adelmo Gabby, the President of the National Securities Commission Eduardo Hecker, and the CEO of Pampa Energy Marcelo Mindlin gave a slightly updated version of the points of view discussed above. They said the new Cabinet Chief Sergio Massa was very open to working with the business and financial sectors, but it is likely that he will have less influence than his predecessor (Alberto Fernandez) to bring about change. They thought it likely that the economy would continue to produce sufficient tax revenue to meet government needs this year, but foresaw a crunch in 2009 when new financing demands will be added to the problems currently evident in the economy.

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¶15. (C) At that point, unless there have been policy changes the price Argentina will have to pay for money internationally and the crowding out effect on local markets will be significant constraints. Key to addressing this is returning credibility to national statistics agency INDEC and implementing a serious anti-inflation policy. They argued that the statistics questions will not be easily fixed, but is essential to so many other important economic and political decisions, including gaining unfettered access to international financing.

¶16. (C) Paris Club debt is another essential issue to address in this context. Unfortunately, they said, it is far from clear that the Kirchners are ready to address these issues forthrightly or effectively. A first good step, they argued, would be to start using dialogue rather than confrontation to tackle problems before the nation. If the Kirchners do not change tactics, they could well face massive defeat in the 2009 elections, they concluded.

Comment

¶17. (C) Foreign bankers are obviously not the only ones

worried. Local bankers are equally pessimistic about the current situation facing the country, and voice similar concerns to those listed above during informal conversations with DAS O'Neill and Emboffs during Ambassador's July 10 reception for visiting WHA A/S Tom Shannon. Both foreign and Argentine financial executives know they have done extremely well over the last five years. However, they also know that there is a long Argentine tradition, honored by both the Argentine public and government, of scapegoating bankers when the economy sours. Therefore, they anticipate that the Kirchners will turn their ire on the banking sector following resolution of the farm strikes, if only to bully banks into lowering interest rates.

118. (U) Treasury DAS Brian O'Neill did not clear this cable.
WAYNE